Foreword: The Costs and Benefits of Cost-Benefit Analysis

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Cost-benefit analysis (CBA) is a controversial yet fundamental aspect of the American regulatory state.[1] Despite its importance, many commentators have argued that the costs and benefits of CBA have not been adequately weighed.[2] Concerns about CBA are all the more salient following the Financial Crisis of 2007–2008 and the Great Recession. In the aftermath of what is generally considered the most severe financial crisis and economic contraction since the Great Depression,[3] scholars and other experts continue to rethink the role of regulation and the tools available to regulators. Although the debate continues about whether we have too much or too little regulation, the Financial Crisis precipitated a historically significant expansion of regulation. The Dodd-Frank Wall Street Reform and Consumer Protection Act, signed into law in 2010, is often considered the most far-reaching financial regulatory reform since the New Deal.[4] The Act

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1. *See infra* notes 26–34 (discussion of the role of CBA).

2. John Coates, for example, notes that "[n]o published study shows empirically that CBA produces benefits that outweigh its costs—whether CBA in practice passes its own test." John C. Coates IV, *Cost-Benefit Analysis of Financial Regulation: Case Studies and Implications*, 124 YALE L.J. (forthcoming 2015) (working paper at 11 n.30) (Eur. Corporate Governance Inst. Working Paper No. 234, 2014), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2375396.

3. Great Depression scholar and Former Federal Reserve chairman Ben Bernanke stated that he believes "September and October of 2008 was the worst financial crisis in global history, including the Great Depression." Financial Crisis Inquiry Commission, THE FINANCIAL CRISIS INQUIRY REPORT 354 (2011); *see also* THE GREAT RECESSION (David B. Grusky et al. eds., 2011) (discussing the effects of the Great Recession on individuals).

4. *See, e.g.*, Edward Balleisen, *The Global Financial Crisis and Responsive Regulation: Some Avenues for*

affects virtually every part of the U.S. financial services industry and created several new regulatory bodies, including the Consumer Financial Protection Bureau, a new independent agency.[5]

In addition to questions about the extent of regulation, the Financial Crisis also raised crucial concerns about how we regulate. Some of these concerns are rooted in a renewed skepticism about the assumptions that underlie complex quantitative models. Amar Bhidé, for example, critiques "top-down measures"—including those of Dodd-Frank—because risk "can be quantified only to a degree."[6] Just as the quantitative models behind complex financial products depended on assumptions that turned out to be faulty, Bhidé cautions against theories of regulation that assume "not just rationality in the ordinary sense of the word, but also universal omniscience."[7] Instead, Bhidé argues for a decentralized approach to regulation and an approach to finance that would take "into account unquantifiable uncertainties and the uniqueness of individual circumstances."[8]

The underlying epistemological concerns about the limits of quantification that some commentators raised in response to the Financial Crisis are also relevant to CBA. As Amy Sinden's article in this issue makes clear, CBA "is not a monolith."[9] Some forms of CBA are more formal than others.[10] Nonetheless, CBA is typically thought of as a fundamentally quantitative methodology. As Arden Rowell writes,

> Modern regulatory cost-benefit analysis is a systemized method of comparing the expected advantages and disadvantages of proposed policies. The method relies on a process of monetization that converts nonmonetary costs and benefits into a common metric—money—by using market- and preference-based studies of people's willingness to pay money to acquire benefits or avoid costs.[11]

Thus, while the exact definition of CBA may be debated, it is typically thought of as a process that aggregates the costs and benefits of a regulation and, where necessary, converts those costs and benefits into a common quantitative metric.

Historical Inquiry, 44 U.B.C. L. REV. 557, 558 (2011) (describing Dodd-Frank as, "depending on one's point of view, the most far-reaching overhaul of national regulatory policy toward the financial system since the New Deal, or a watered down set of technical fixes that do too little to tame the ever more powerful, and dangerous, beasts of finance").

5. Dodd-Frank Wall Street Reform and Consumer Protection (Dodd-Frank) Act, 12 U.S.C. § 5491 (2012).

6. AMAR BHIDÉ, A CALL FOR JUDGMENT: SENSIBLE FINANCE FOR A DYNAMIC ECONOMY 276 (2010).

7. *Id.* at 271.

8. *Id.* at 282–83, 289.

9. Amy Sinden, *Cost-Benefit Analysis, Ben Franklin, and the Supreme Court*, 4 U.C. IRVINE L. REV. 1175, 1176 (2014).

10. *Id.* In addition to variation in the form of CBA, another important set of distinctions involve to what extent and in which ways CBA is or is not legally mandated. *See* Coates IV, *supra* note 2 (manuscript at 9–11).

11. Arden Rowell, *Time in Cost-Benefit Analysis*, 4 U.C. IRVINE L. REV. 1215, 1218 (2014) (citing Arden Rowell, *The Cost of Time: Haphazard Discounting and the Undervaluation of Regulatory Benefits*, 85 NOTRE DAME L. REV. 1505, 1517–20 (2010)).

CBA may therefore be susceptible to the critiques of quantification discussed above. For example, Frank Ackerman and Lisa Heinzerling critique CBA because it requires quantifying "priceless" values, like human health and safety or the ethical principles underlying environmental protection.[12] Instead, Ackerman and Heinzerling argue for a "holistic approach, where costs as a whole (usually monetary) and benefits as a whole (often largely nonmonetary) are considered together—but are not forced to be expressed in the same units."[13]

Of course, CBA has many defenders and advocates.[14] Some scholars have emphasized the importance of CBA in enhancing efficiency[15] or even rationality.[16] Others have argued that CBA can strengthen democratic accountability because it makes agency decision making more transparent to both the public and elected officials and insulates "agencies from powerful political pressures."[17]

Recent scholarship has also attempted to reframe the debate by moving it from an absolutist "for or against" to a more contextual "when and how." Scholars have argued, for example, that CBA's practitioners should abandon a narrow focus on economic efficiency and instead focus more broadly on maximizing well-being. In short, cost-benefit analysis should be redubbed well-being analysis (WBA) and use the metric of happiness, broadly defined, rather than money.[18] Because it seeks to directly measure the effects of regulations on people's well-being, WBA may avoid the "distortions created by using money as a proxy for people's quality of life."[19] In another effort to reframe the debate, Richard Revesz and Michael Livermore argue that what is often thought of as CBA's antiregulatory bias is "historical rather than conceptual."[20] According to Revesz and Livermore, reform can remove CBA's "systematic antiregulatory biases."[21] With the addition of "distributional analyses of

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12. FRANK ACKERMAN & LISA HEINZERLING, PRICELESS: ON KNOWING THE PRICE OF EVERYTHING AND THE VALUE OF NOTHING (2004).

13. *Id.* at 212.

14. For a review of the debate surrounding CBA, see Rowell, *supra* note 11, at 1216.

15. *See, e.g.*, Matthew D. Adler & Eric A. Posner, *Rethinking Cost-Benefit Analysis*, 109 YALE L.J. 165, 187–94 (describing the "conventional defenses of CBA," including Pareto and Kaldor-Hicks efficiency).

16. *See, e.g.*, RICHARD L. REVESZ & MICHAEL A. LIVERMORE, RETAKING RATIONALITY: HOW COST-BENEFIT ANALYSIS CAN BETTER PROTECT THE ENVIRONMENT AND OUR HEALTH 12 (2008) ("For certain kinds of governmental programs, the use of cost-benefit analysis is a requirement of basic rationality.").

17. Paul Rose & Christopher J. Walker, *Dodd-Frank Regulators, Cost-Benefit Analysis, and Agency Capture*, 66 STAN. L. REV. ONLINE 9, 13–14 (2013); *see also* REVESZ & LIVERMORE, *supra* note 16. *But see* ACKERMAN & HEINZERLING, *supra* note 12, at 215 ("The frequent claims that cost-benefit analysis would provide objectivity and transparency in decision making have the story backward: a holistic evaluation is desirable precisely because it is more transparent and accessible to participation, because it avoids the opaque technicalities that characterize cost-benefit studies in practice.").

18. *See, e.g.*, MATTHEW D. ADLER & ERIC A. POSNER, NEW FOUNDATIONS OF COST-BENEFIT ANALYSIS (2006); John Bronsteen et al., *Well-Being Analysis vs. Cost-Benefit Analysis*, 62 DUKE L.J. 1603 (2013).

19. Bronsteen et al., *supra* note 18, at 1689.

20. REVESZ & LIVERMORE, *supra* note 16, at 10.

21. *Id.* at 191.

the cumulative effects of regulation," a reformed CBA could lead to a fairer and more efficient administrative state.[22] In a still more recent effort to recast CBA, Robert Ahdieh writes that CBA in financial regulation should take on a broader, less quantitative but equally rigorous form.[23] Ahdieh also emphasizes the importance of "embracing a discourse of cost-benefit analysis focused on the diversity of functions it may serve and the varied forms it may take."[24] Ahdieh points to four factors—the source of law, the nature of the responsible agency, the nature of the problem, and the variables to be analyzed—that should be weighed in determining whether or how CBA should be used in a given situation.[25]

Regardless of the current state of the academic debate surrounding CBA or the renewed skepticism about quantification following the Financial Crisis, it is unlikely that the importance of CBA will diminish anytime soon. CBA is required by numerous statutes and has been embraced by each successive presidential administration, both Democratic and Republican, since President Reagan mandated CBA by executive order in 1981.[26] Recent events suggest, if anything, that CBA is becoming more influential and perhaps more quantitative. The proposed Independent Regulatory Analysis Act,[27] which is strongly opposed by many environmental and public interest groups[28] and strongly favored by many business groups,[29] would allow the President to require independent agencies, including the newly formed Consumer Financial Protection Bureau,[30] to conduct CBA even when it is not otherwise mandated by statute.[31] Moreover, Arden Rowell writes in this issue that a new executive order under President Obama exhibits "a heightened emphasis on the importance of quantification over prior cost-benefit orders," according to a number of commentators.[32] Recent court decisions also affirm the continued importance of CBA. Perhaps most notably, in *Business Roundtable*,[33] the District of Columbia Circuit vacated a Securities and Exchange Commission (SEC) rule because, according to the court, the SEC failed to adequately weigh the costs

22. *Id.*

23. Robert B. Ahdieh, *Reanalyzing Cost-Benefit Analysis: Toward a Framework of Function(s) and Form(s)*, 88 N.Y.U. L. REV. 1983, 2070–71 (2013).

24. *Id.* at 1993; *see also* Sinden, *supra* note 9, at 1177 (discussing different conceptions of CBA).

25. Ahdieh, *supra* note 23, at 2025–35.

26. REVESZ & LIVERMORE, *supra* note 16, at 11; Bronsteen et al., *supra* note 18, at 1606.

27. Independent Agency Regulatory Analysis Act of 2013, S. 1173, 113th Cong. (2013).

28. *See, e.g.*, Impact of the Independent Regulatory Analysis Act, S. 3468: Further Delaying Needed Safeguards for Our Economy, DĒMOS: IDEAS & ACTION, http://www.demos.org/sites/default/files/publications/Impact%20of%20the%20Independent%20Regulatory%20Analysis%20Act%20S_3468.pdf (last visited Sept. 26, 2014).

29. *See, e.g.*, *BRT Letter Supporting S.3468, The Independent Agency Regulatory Analysis Act*, BUS. ROUNDTABLE (Sept. 18, 2012), http://businessroundtable.org/resources/brt-letter-supporting-s.3468-the-independent-agency-regulatory-analys1.

30. For a discussion of the Independent Agency Regulatory Analysis Act in the context of consumer protection, see Jeff Sovern, *Can Cost-Benefit Analysis Help Consumer Protection Laws? Or at Least Benefit Analysis?*, 4 U.C. IRVINE L. REV. 1241, 1242–43 & n.4 (2014).

31. S. 1173.

32. Rowell, *supra* note 11, at 1220.

33. Bus. Roundtable v. SEC, 647 F.3d 1144 (D.C. Cir. 2011).

and benefits of the rule as a formerly obscure section of the National Securities Market Improvement Act required.[34]

An understanding of the costs and benefits of CBA is all the more important given the expansion of rulemaking under Dodd-Frank. It is still unclear just how pervasive CBA will be or what form of CBA will be adopted in the context of financial regulation. Some commentators have argued that financial regulation is particularly well suited to CBA, while others have argued precisely the opposite. For example, John Coates offers a series of case studies and concludes that while some forms of CBA may be useful, quantitative CBA is "not currently feasible with any degree of precision and reliability for representative types of financial regulation."[35] Instead, Coates emphasizes the centrality and inescapability of expert judgment.[36] In the context of financial regulation, according to Coates, CBA is therefore more likely to "camouflage" underlying motivations than to inform the public or discipline regulators.[37] In contrast, Eric Posner and Glen Weyl argue that, if anything, CBA is better suited to financial regulation than to other forms of regulation, because the costs and benefits of financial regulation are "almost all monetary," and are thus easier to estimate and compare.[38]

Determining the right role, if any, for CBA in financial regulation—or any regulatory field—depends on understanding the costs and benefits of CBA in the contexts in which it is practiced. A better understanding of the many facets of CBA involves addressing at least three questions: (1) What is CBA? (2) What are the challenges of quantifying costs and benefits and how can those challenges be addressed? (3) What are the "on-the-ground" regulatory problems that CBA must be able to account for if it is to be an effective regulatory tool in a specific context? The three articles in this issue make important contributions toward addressing these questions.

Amy Sinden's article highlights the "wide and divergent array of decision-making practices" encompassed by CBA.[39] Through a case study of *Entergy v. Riverkeeper*, a 2009 U.S. Supreme Court case involving the Environmental Protection Agency's (EPA) interpretation of Clean Water Act regulations related to power-plant cooling water intakes, Sinden reveals the importance of "distinguishing among

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34. For a detailed analysis of the implications of *Business Roundtable*, see Ahdieh, *supra* note 23.

35. Coates IV, *supra* note 2 (manuscript at 85).

36. For another example, see BHIDÉ, *supra* note 6. While Bhidé emphasizes the importance of judgment to a productive financial system, he advocates judgment that is decentralized and rooted in relationships.

37. Coates IV, *supra* note 2 (manuscript at 11–15, 85).

38. Eric A. Posner & E. Glen Weyl, *Benefit-Cost Paradigms in Financial Regulation* 13 (Univ. of Chi. Coase-Sandor Inst. for Law & Econ. Research Paper No. 660, 2014), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2346466; Eric A. Posner & E. Glen Weyl, *Cost-Benefit Analysis of Financial Regulations: A Response to Criticisms*, 124 YALE L.J. F. (forthcoming 2015) (working paper at 13) (Univ. of Chi. Coase-Sandor Inst. for Law & Econ. Research Paper No. 683, 2014), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2436538.

39. Sinden, *supra* note 9, at 1176.

different forms of CBA."[40] In particular, Sinden distinguishes between formal and informal forms of CBA. She cautions against what she calls "false formality," which occurs when agencies "fail to clearly define where on the formality-informality spectrum a particular CBA falls" and "inappropriately combine[] elements of formal and informal CBA."[41] False formality leads to irrational outcomes because it results in the misinterpretation of doctrine, muddies debate, and produces intellectual incoherence.[42]

Arden Rowell's article takes on the task of explaining how CBA can value future costs and benefits. She argues that two aspects of time pose distinct challenges for cost-benefit analysis.[43] First, temporal asymmetry means that time only flows in one direction. This means that "[r]esources, information, harm, and risk can only be presented from the present *to* the future."[44] Temporal asymmetry therefore "undermines the possibility of meaningfully reciprocal relationships between the present and the future."[45] Rowell argues that regulators should respond to this temporal challenge by being especially attentive to the distributional issues related to temporal asymmetry.[46] Second, the "flow" of time creates challenges for managing the "temporal scope" of cost-benefit analyses.[47] For example, what is the proper endpoint when calculating the costs of nuclear waste?[48] To respond to this challenge, Rowell argues that regulators should clearly delineate the temporal scope of their analyses.[49] Rowell also suggests that regulators "consider calculating temporal 'break-even' points to identify the time point when the benefits of a rule will have justified the costs."[50]

Finally, Jeff Sovern discusses CBA from the perspective of a leading scholar of consumer law. Sovern notes that while CBA has often troubled consumer advocates, it may help consumers if it is responsive to the challenges regulators face when crafting effective consumer protection regulations.[51] For example, Sovern explains that many consumer protection rules fail because consumers fail to use them.[52] Sovern's article therefore provides an important insight into the kinds of complex behavioral considerations for which CBA must be able to account. Sovern also notes the difficulty CBA may face when it attempts to measure the costs and benefits of some rules ex ante.[53] He argues that pilot projects and variation in policy

40. *Id.* at 1178.
41. *Id.* at 1177.
42. *See id.*
43. Rowell, *supra* note 11, at 1222.
44. *Id.* at 1224.
45. *Id.*
46. *Id.* at 1228.
47. *Id.* at 1230–31.
48. *Id.* at 1232–33.
49. *Id.* at 1239.
50. *Id.*
51. Sovern, *supra* note 30, at 1243.
52. *Id.* at 1244.
53. *Id.* at 1260.

across states may be particularly useful for evaluating policies in such cases.[54] Some benefits of consumer protection, such as financial privacy, may also be particularly difficult to quantify.[55] Sovern argues that consumer protection agencies "should attempt to demonstrate that protections will have benefits, but should not necessarily be forced to quantify those benefits, because often the benefits cannot be quantified."[56]

Given the evolving and potentially expanding role of CBA, scholarship on CBA is more important than ever. As important as CBA is, it also raises issues that go well beyond CBA, including the nature and purpose of regulation, the role of courts in reviewing administrative decisions, and epistemological questions about the limits of quantification. Indeed, rethinking CBA may even provide a key starting point for rethinking regulation more broadly. The articles in this issue make an important contribution to this crucial and undoubtedly ongoing discussion.

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54. *Id.* at 1159–60; *see also* Charles F. Sabel & William H. Simon, *Minimalism and Experimentalism in the Administrative State*, 100 GEO. L.J. 53 (2011) (advocating experimentalism rather than CBA).

55. Sovern, *supra* note 30, at 1262.

56. *Id.* at 1261–62.